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CENTRAL INTELLIGENCE AGENCY WASHINGTON 25, D. C.

HR70-14

2 January 1952

MEMORANDUM FOR THE RECORD

SUBJECT: CAT

I was introduced to the CAT question at a meeting in Mr. Wolf's office attended by Mr. Wolf, Mr. Lawrence Houston, Col. Taylor, Col. Stilwell and Mr. Arthur Jacobs. Later I had interviews with Mr. Jacobs, Mr. our accountant whom we sent to Taiwan to review the CAT figures, and with Mr. Ed Taylor, Lybrand, Ross and Montgomery, independent certified accountants who had been to Taiwan and audited the books of CAT. I also spent several hours with Col. Stilwell, Mr. our working accountant at Taiwan who was sent out shortly after we acquired CAT, and Mr. who was sent to CAT in 1949 and who has just returned; and on 17 December 1951, I talked briefly with Mr. of the Commercial Division who is new with the problem, and again with Mr. Jacobs.

I have reviewed a 17-page memorandum prepared by Mr. Jacobs about CAT matters; a memorandum of 7 December 1951, signed by Mr. Jacobs, on CAT matters and, of course, all the agreements between ourselves and CAT. I have also reviewed the auditors' working papers and have discussed details therein with all the auditors named above and believe, therefore, that I have all the information and informed opinions available within the Agency with respect to CAT.

I have found that there are still several open items under our first 1949 contract; that there are open and unsettled items under the purchase agreement; and that the existence of these sources of conflict and our apparent inability to settle them has caused the CAT management, which we still rely upon strongly, to lose confidence in the Agency and vice versa. I also find that there has been a conflict within the Agency between the operators under Col. Stilwell and the administrators responsible for the business operations of CAT, of whom Mr. Jacobs has made himself the spearhead, with the result that the operators have, to some extent at least, the feeling that their capacities are impaired.

A settlement meeting with Mr. Corcoran, representing the sellers, was held by Mr. Wolf, Mr. Houston and myself on 20 December 1951 at my office, at which the entire open transactions were reviewed and the decisions made below reached. Messrs. Wolf, Houston and Hedden all concur in these decisions.

APPROVED FOR RELEASE□DATE: 20-Mar-2009

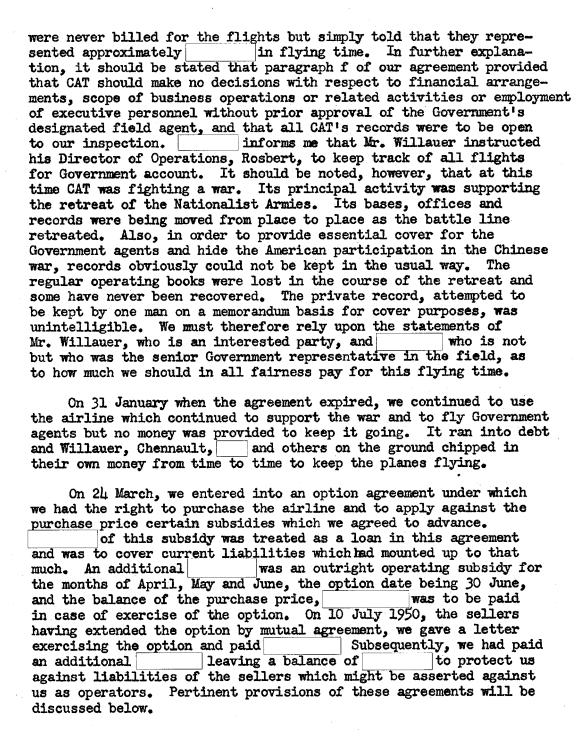
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HISTORY

To understand this situation fully, it is necessary to review briefly the history of our relationship with CAT.

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It will be seen from the above that we did not subsidize the line from 1 January until 24 March and to the extent that our advances for April, May and June were considered part of the purchase price, we did not subsidize the line at all from 30 January until 30 June. In view of the above facts, it could be argued that as the line was being kept during this period primarily for our use and convenience, we have a moral obligation to reimburse the sellers for Government flights during that period, although no such claim has ever been pressed.

We have now had an audit by Lybrand, Ross and Montgomery which shows assets of over Our total investment, including all subsidies from the earliest one in 1949, is approximately just back from the field, says we could sell the planes alone in today's market for over our cost of the entire operation. It would therefore seem that the previous owners were neither greedy nor profit—minded in the deal they made with us and that we have no apology for this investment even on business grounds. On operational grounds, it has been one of the most successful projects CIA has undertaken. It was invaluable to the Army in sustaining the early operations in Korea. It is still considered essential by the Army for Korean operations and in addition has won the commendation of the Joint Chiefs in other specific missions it has accomplished.

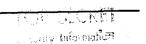
OPEN ITEMS

There are open claims against CIA by the sellers and claims which have been asserted by CIA against the sellers under all the above agreements. These claims and the decisions I have made with respect to them are as follows:

A. Claims of Willauer Trading Corporation Against Us.

1. Under the 1949 contract:

a. They claim that we have never paid for flying the special missions as required under the 1949 agreement. The basis of this claim was discussed above. The reasons it has not been paid are first that no satisfactory accounting has been rendered to us; secondly, that the deficit of the corporation may have been less than the maximum we paid and, to the extent that payment for the special missions would reduce the deficit below the money would come back to us because the payment would be operating income and reduce the deficit; and thirdly, because we have never made a real effort to settle these questions.



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I think we are bound to accept the report
of our own auditor, that the deficit
for this period is . On this basis,
any claim which we recognize up to
is a legitimate claim of the sellers against us.
There are no adequate records upon which this
claim can be sustained. This is partly because
the airline was fighting a war at this time,
moving its books every few weeks and requiring
the time of the Senior Executive in actually
flying missions for us. Another reason is that
to protect security and hide the interest of the
US, instructions were given not to charge any
of this time on the regular books of the company.
Mr. Willauer did give heard him) special
instructions to his Director of Operations, Rosbert,
to keep track of these flights. Rosbert's records
are not in existence and were probably destroyed
for security reasons. Mr. Willauer estimates his
flying time at our man, estimates
it at a minimum of and a maximum of
Decision
We have agreed to allow the sellers

b. Cost of the Sanya Base.

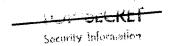
in settlement of this claim.

Under the 1949 agreement, we requested the sellers to establish a new base at our expense at Sanya on Hainan. Much money was spent on it but before it was completed Hainan was taken over by the Communists. The sellers claim that the amount they spent should be reimbursed to them, as we increased the initial commitment.

Decision

There was a limit in our 1949 agreement of the total amount we would pay for both the Sanya Base and to recompense operating deficits; namely,

Therefore, if the deficit was increased by the cost of the Sanya Base, it must be at the sellers' expense and we cannot recognize any liability of the Agency.



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Net Cost of SS SACRAMENTO.

In December of 1949, the shop equipment of the airline was at Kunming, inland. It was then flown to Sanya. It became necessary to move it to Formosa. The sellers chartered the barge SACRAMENTO in Tokyo to assist in this moving. The use of the barge was delayed while the previous owners got a Lloyd's Certificate of Approval. The barge was sent to Hong Kong, encountered a storm, became unseaworthy and could not be used for the purpose for which it was chartered. Sanya was evacuated by air.

Decision

accounting.

This matter, like the Sanya Base costs, falls
under the limit the 1949 agreement placed
upon our subsidy. To the extent that these costs
brought the loss above we have paid for
the barge. To the extent that the loss exceeds
it is not our liability. There may be
a recovery from Lloyd's on the charter. If such
a recovery is obtained, we think it belongs to
the sellers and will so agree.
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Claims Under the 1950 Purchase Agreement.
Claims officer the 1990 Furchase Agreement.
The sellers have made the following claims under the 1950 purchase agreement. These claims have been made without the benefit of having seen the accounting and with the acknowledgment that the accounting may recognize them and eliminate the claims.
a. Claim of appearing as "reserve for contingencies" in the 12/15/50 accounting.
Decision
The independent auditors did adjust this and credited to the sellers.
b. Balfour Guthrie balance as of 7/1/50 of
Decision

The independent auditors have already credited this to the sellers in their preliminary

agraphy tale scales

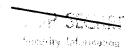
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c.	Washington office expense of which the sellers say Mrs. of our office recognized as not a proper charge against the sellers, but which we asserted as a claim against the sellers. Our accounting shows only of such charges for the period subsequent to 30 June 1950 and these were reimbursed and credited to the account of the sellers by the independent auditors. Decision
	Decraton
	Credit only the amount the auditors allowed.
d.	Payroll rebate.
	An estimate of the sellers that of the American home allotments and American field allotments are properly payable by us as belonging to the period subsequent to 30 June 1950. Our accounting shows that we did credit on this account to the sellers as representing allotments for July 1950 and that the figure, which the sellers believe should be credited with approximately is after deducting this
	Decision
	No further allowance should be made.
e.	CAT parts.
	Mbs

The sellers allege that we are in the course of receiving in money value some worth of parts turned over to the China Air Force by the Willauer Trading Corporation prior to 1 July 1951, and should credit them with the value as received.

<u>Decision</u>

This value belongs to the sellers, but should come to us to offset services we have rendered them.



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f. Key Money and Miscellaneous Receivables, Estimated by the Sellers at

Key money is peculiar to the Far East. It is the bonus you pay to take a lease. You are not entitled to receive it back from the landlord at the expiration of the lease but if premises are still scarce you can recoup by demanding key money of your successor.

Decision

We should keep the key money on Chennault's house if and when received. If any money is obtained on the releasing of upon which we have never paid any rent, we should permit this to go to the old company.

g. Jamco Bill.

The accounting shows a charge of approxi-
mately against the sellers for engine
overhauls. The sellers claim this is unfairly
charged to them. The auditors (Lybrand, Ross
and Montgomery) put this charge in the accounting
and Mr. agreed with them that it was a
proper charge. When they returned to this
country, however, Mr. Ed Taylor, Lybrand, Ross &
Montgomery, learned from our Mr. who was

the contract officer in the case, that Mr. Willauer had fully explained to him the facts with respect to these engines at the time the contract was signed. Willauer disclosed then that the engines were in the maintenance shop, that the cost of rehabilitating them would have to be paid when they were taken out and that the company had been in the habit and practice of not considering the accrued charges on the maintenance of engines as a payable until the engines were taken down and used and that then the cost of rehabilitation was amortized as they were flown. In view of the fact that this disclosure was made, Mr. Ed Taylor felt there was a serious question as to the propriety of charging the cost to the old company. Mr. Jacobs disagrees. In addition to these facts, it is clear that in the inventory, Schedule B to the contract, the engines were described as "100 engines awaiting first overhaul in most cases." The contract proper, clause 5.03B, permits liens on the property we bought "for claim of labor, materials or supplies not delinquent."

Decision

It is clear that under the practice of the company the claims for the accrued work on these engines were not delinquent. It is also clear that we were under full notice of the status of the engines and all parties admit that we bought "as is where is." Under these circumstances, we see no basis for charging the sellers for the amounts we paid subsequent to purchase as we drew these engines out of maintenance and used them. We think these charges were proper operating charges against the ensuing use of the engines and propose to credit the account with of the and charge them with the balance which represents regular

maintenance.

B. CATI Claims.

CAT. Inc., and Mr. Corcoran assert two claims of CATI. He acknowledges that these have nothing to do with either of the 1949 or 1950 contracts but would like these two matters cleaned up if we are arriving at a settlement because he is involved in both.

When CATI won its lawsuit on the West Coast 1. it acquired a substantial group of airplane spare parts. The management of CAT on Taiwan knew about these and thought they would be useful in the business. Telegrams were therefore exchanged by Willauer, representing CAT, and Youngman, representing CATI, under which CAT agreed to purchase of such spare parts. Mr. Jacobs has asserted that no one in the Agency ratified this purchase or knew of it and that, because Willauer had an indirect interest in the selling company, the action is rescindable. It developed, after the exchange of telegrams, that CAT only really of the needed at this time approximately parts.

The facts seem to be that according to our man, that Hugh Grundy, Chief of Maintenance for CAT and having no interest in either corporation, was the one who put the pressure on Willauer to purchase these parts. Grundy knew how difficult it was to get parts and wanted them. A month before this, Col. Stilwell had been in Taiwan and discussed putting the company into self-maintenance and obtaining a 4-engine plane. The parts included spares for a 4-engine plane. The exchange of telegrams between representing CAT, and

here, representing Youngman, show sharp disagreement on the terms of purchase. At this time we were buying lots of spare parts in other places which we did not immediately need. When the minutes of the board in Taiwan came before the group here for approval, the meeting here broke up because during the meeting word came in of the successful achievement of a difficult and valuable mission for the Joint Chiefs, which mission OPC refers to as Miracle No. 1.

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In June 1951 when Mr. Willauer was in Washington, he learned that he was being critized because of this spare parts purchase and went to Col. Stilwell and offered him three options with respect to this transaction: the first, to ratify the transaction; the second, to cancel it completely; and the third, to take only such of the parts as we wanted but stating that if the third option were decided upon the price should be adjusted to the current market value of the parts. He offered to permit Col. Stilwell to send his own man out to select the parts he wished and to reprice them. Stilwell had no one to use for this purpose and therefore ratified the transaction.

There is no question but that our independent counsel has advised us that it is a good contract.

Decision

In view of the above facts, there is no basis now to assert any claim for recission on the contract. We therefore intend to allow the full amount to the sellers.

C. Claims of the Agency Against the Sellers.

The Agency has no claims against the sellers under the 1949 contract although Mr. Jacobs has submitted that we may assert a claim for a return of any excess of the total advances over the total authorized utilization.

Decision

As it is clear from our own auditor's statement that there are no such excesses, this is not considered a claim which we have any right to assert.

Under the 1950 contract there are seven	ral charges of
adjustments which the auditors have recomme	ended, as
indicated in the attached Tab A, a copy of	the statement
	The net of
the auditors' figures shows a slight balance	ce due the
sellers on account of the remaining	ng unpaid under
the contract.	-

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Decision

The independent auditors' figures are accepted without question except for the Jamco account payable referred to above.

In addition to the claims reduced to dollar amounts, Mr. Jacobs has recommended that certain other claims be asserted and has called our attention to the following items:

1. Annual Leave Allowances.

The auditors agreed that there were no accrued obligations of this nature as of 15 August 1950, the date after which we agreed in the option to pay such allowances. The predecessor company had been under the habit of accruing a charge for vacation leave on a monthly basis. It has been suggested that these accruals are a proper charge against the sellers.

Decision

As paragraph 4 of the agreement of 10 July provides that any and all such allowances "which may become due after 15 August 1950" shall be taken over by us and as the contracting officer and counsel agree that the sellers insisted upon this language to clarify this very point, we do not think it is fair to assert such a claim.

Interest on Employees' Savings.

The savings plan provided that employees' contributions be set up in an independent financial institution. This has not been done. Because the management intends to add interest retroactively, it is asserted that the interest allocated to the fund as of 1 July 1950 should be treated as a liability of the sellers.

The amount is negligible. There is serious doubt that the employee is entitled to any interest if it were not actually earned. In any event, it will take years to determine what the small amount involved is because no employee relieved for cause is to share in the interest.

Decision

Forget it, as de minimus.

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3. Possible liability for income tax withholding which the old company failed to make on such employees if any who may have returned to the country before the necessary time which excuses them from American taxes.

Decision

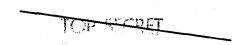
We do not believe there is any such liability and if there is the Government has no way to assert it because it is against a foreign partnership. Disregard it.

D. Chinese CAA Claims

CCAA has asserted claims for a period prior to our
ownership in the face amount of Our man,
states that he had this investigated by his
Chinese liaison, an employee named who reported
that CCAA has no records to support such claim, having
lost the records in the retreat. In any event, recent
cables indicate that this claim can be settled for
which amount will also relieve us of
a current operating claim of a month for the
year 1952. The sellers claim to have offsets against
CCAA of many times the amount of their claim against the
sellers.

Decision

This appears to be simply a squeeze. To the extent that we have to pay it, there is a legitimate claim against the sellers but they are entitled to refuse to recognize it unless we allow them to assert their offsets. This will drag the matter out indefinitely, and we are anxious to get a settlement. We have therefore decided to accept the recent compromise offer of CCAA which will eliminate the claim and will cost us nothing because it will also eliminate a current operating charge for landing fees of a greater amount. To compensate, the sellers will not assert a legitimate claim they have against us for airplane parts which we are receiving and are entitled to receive from the Chinese Air Force to an amount equal to as repayment for parts which the sellers gave to the Chinese Air Force prior to the March 1950 agreement with us.



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At approximately 6:30 p.m., 18 December 1951, Col. Stilwell talked at my request on the telephone with our man, in San Francisco, who knew all the facts about these spare parts and who did confirm that they are due to the old company in approximately the amount asserted. I realize we must rely upon the good will and help of Willauer to obtain these parts but that is one purpose of this settlement.

E. Claims of Chinese Customs Department.

Such claims have not been asserted and we cannot delay this settlement because of that possibility. We must simply refuse to recognize any such claim at this late date.

F. Pesos Loan.

The accountants have credited the sellers with the proceeds of a loan of Philippine pesos because we got the money. On this basis, the lenders may assert a claim against us for repayment. The money was borrowed by CATI.

Decision

We are accepting the accountants' recommendation that we credit the sellers with this amount. We will obtain an indemnity from CATI which has assets in this country of over this amount against the claim being asserted against us later. CATI has lent twice this amount, within the past year, to the bank which made the pesos loan, so this is a complete offset.

G. Youngman Loan.

When the airline was out of money, Youngman individually forwarded to pay pilots' wages. We received this money and have credited the sellers with it. The sellers have repaid Youngman.

Decision

We will obtain a statement from Youngman that the loan has been paid.

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L	Advance under 24 March Agreement.
ļ	Decision
i	Although there is language in the 10 July agreement holding the sellers accountable for any excess in this amount "over operating expenses," it is difficult to see how the sellers have any such liability.
	Our counsel agrees that we are on too weak ground to assert this claim. The funds are declared to be part of the purchase price. The waiving language is not adequate because obviously operating expenses exceeded this amount although the deficit may not have. Our own accountants think the deficit would exceed this amount.
1	
	Decision
	Note: The description of the state of the st
	The sellers admit this claim, if valid, would be a
,	White-the-the-derivative-the-stages
'	The sellers admit this claim, if valid, would be a legitimate deduction. Mr. Houston has pointed out that there is an executive of in New York who knows of CIA ownership of CAT and that therefore we can
•	The sellers admit this claim, if valid, would be a legitimate deduction. Mr. Houston has pointed out that there is an executive of
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J. Service Charge.

We have performed certain services for the old company. We have paid the salary of an old company pilot who was in captivity when we took over and who is still in captivity. Mr. Jacobs also thinks that we should allocate to the sellers part of the cost of our audit.

Decision

We see no basis for any claim against the sellers on any of these grounds with the possible exception of a quantum meruit claim for services performed. We are offsetting this, which includes the services of Mr. Brennan for the next year, against any claim the sellers might have against us for the use we have been making with their permission and without compensation of a fleet of automobiles, a large amount of radio equipment, furniture, etc., in our Tokyo office and other property belonging to CATI and CNAC.

K. Franchise.

Mr. Houston has pointed out that we have no formal agreement recognizing that the franchise under which CAT operates is held by Gen. Chennault and Mr. Willauer as agents for this company. The sellers have suggested in the past that we should provide indemnification to Gen. Chennault and Mr. Willauer against any liabilities that may be asserted against them as holders of the franchise.

Decision

Such indemnification would be proper and would constitute adequate consideration for a trust or agency agreement which confirmed the beneficial interest of the company and the franchise. However, as practice has ratified the agency relationship, it was decided to do nothing now about this.

SUMMARY

Attached Tab B is the final agreement made on the basis of the above with Mr. Corcoran of claims on open matters as of the date of purchase and arising out of the purchase contract. All

Charge the Links

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open matters between the sellers and CAT and between CATI and CAT have now been finally settled on the basis of the considerations above and by agreement between Mr. Corcoran, representing the sellers and CATI, and Mr. Wolf, Mr. Houston and Mr. Hedden, representing the Agency, with the result that:

A.

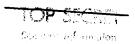
В.

the	Agency, with the result that:
We	are to receive:
1.	An indemnity from CATI against any liability on the Pesos Loan.
2.	An indemnity from Youngman against any liability to repay the Youngman advanced.
3.	To the extent that there be realized approximately of spare parts owed by the Chinese Air Force to the sellers under the barter agreement above. There is to be no comeback if the amount realized is less than no matter how much less.
4.	CAT is to have the right to use without compensation for so long as CATI can make this right available to us, the motor pool, radio parts, communications equiment, furniture and real estate of CATI and CNAC now being used by CAT which is to be under no obligation for past use of such equipment.
5.	Key money, if any, received with respect to Gen. Chennault's lease.
6.	The return of the promissory note issued under the purchase agreement.
The	e sellers are to receive from us:
1.	A quit claim for services we have rendered to the sellers in the past, plus the right to use Mr

receive his salary from CAT.

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2.	representing the balance due according to the auditors' statement.
3.	Jamco claim for overhauling engines which the auditors did not credit to the sellers in their preliminary statement but which on the basis of facts learned subsequently they indicated should probably have been credited.
4.	to compensate and discharge all claims for flying time under the 1949 contract including quantum meruit claims for the period from the expiration of the 1949 contract and until we started to pay for such flights.
5.	Key money, if and when they can collect it, on the houses rented by and is to belong to the sellers.
6.	The recovery, if any, which they can obtain from the insurance on the SS SACRAMENTO.
	Stuart Hedden
that first paid[balan to sa These memor so fa	afterthought, I realize there is substantial evidence this deficit exceeded the subsidy because out of their installment of the purchase price, the sellers have of liabilities which appeared on the 24 March ce sheet and which it would have been proper for them tisfy out of the subsidy had there been any margin. are the liabilities which are listed in the Youngman andum in the file and which L. K. Taylor has refused or to allow as a charge against his share of the case price.



*Note: